80450-8

No. 58825-7-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION 1

COLONIAL DEVELOPMENT, LLC, a Washington limited liability company,

Defendant// Appellant,

v.

EMILY LANE TOWNHOMES CONDOMINIUM OWNERS' ASSOCIATION, a Washington nonprofit corporation,

Plaintiff// Respondent/Cross-Appellant.

REPLY BRIEF OF RESPONDENT/CROSS-APPELLANT EMILY LANE TOWNHOMES CONDOMINIUMS OWNERS' ASSOCIATION

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I. FACTS

The Court must conduct de novo review of an order granting summary judgment. *Aaro Medical Supplies, Inc. v. Department of Revenue*, 132 Wn. App. 709, 714, 132 P.3d 1143 (2006). "[A]ll facts or inferences therefrom [must be] construed most favorably to the non-moving party." *King County v. Taxpayers of King County*, 133 Wn.2d 584, 616, 949 P.2d 1260 (1997).

The facts are hotly disputed. The Emily Lane Townhomes Condominium Association (the "Association") alleges that the Emily Lane Townhomes Condominiums (the "Project") is plagued by many latent defects and building code violations, and that the developer and general contractor, Colonial Development, LLC ("the LLC"), secretly dissolved itself without resolving numerous warranty requests or disclosing the defects to the Association seven months before its warranty obligations expired. The following evidence supports the Association's claims:

A. Construction Defects.

Anthony Lang, after an intrusive on-site investigation, testified to the following defects at the project, among others:

- **Missing balcony saddle flashings** were discovered which violates clause 1402.2 of the UBC. This condition was observed at balcony locations and **has resulted in damage to gypsum and OSB sheathing due to water ingress.**

- The **walkways throughout the complex were improperly flashed** which violates clause 1402.2 of the UBC. This condition **has allowed water ingress** into the structure damaging gypsum sheathing and wood framing members.

- **Unsealed penetrations** through the building envelope and unit separations were observed at ceilings, exterior walls, and attic draft separators throughout the complex. This condition violates clause 502.4.3 of the WA EC, and has likely contributed to mold growth observed within exterior wall assemblies and on the underside of roof sheathing.

- **Guardrail posts** installed at walkways throughout the complex were **attached by either toe nailing** through the waterproof membrane and into the sheathing and/or framing, or with lag bolts through notched section, with lag bolts that were often counter sunk into the notched wood. Post attachments **have become even weaker by reason of water intrusion and rot** at or near the attachment points. True and correct exemplar photographs of these conditions are attached. In both cases **as constructed the guardrails are unable to withstand minimal structural loads**. This condition violates Table 16 of the UBC.

- Some of the **windows observed had broken nailing flanges** violates AAMA 2400-02, a publication of the American Architectural Manufacturers Association. This condition was observed at windows in Building C and could have contributed to the windows **failing a water test**.

- Some of the windows observed had nails punched directly through the window flange and not through the pre-punched nail holes, which violates AAMA 2400-02. This condition was observed at windows in Building C. And could have contributed to the cracked window flange and failing a water test.

- Some of the windows were installed with nails located within 3 inches of the corner of the frame, which violates AAMA 2400-02. This condition was observed at windows in Building C and could have contributed to the cracked window flange and failing a water test.

- There was no diverter flashing installed at the base of roof to wall junctures. This condition was observed throughout the complex and violates clauses 1402.1, 1402.2, and 1509 of the UBC, and clause 3.6.4.2 (Volume 2) of the NRCA (*Roofing and Waterproofing Manual* published by the National Roofing Contractors Association).

- The felt underlay installed at the roof was discontinuous at various areas and missing at the roof valleys. This condition was observed at the Garage structure and violates table 15-B-1 and clause 1508.2 of the UBC.

- Openings in exterior walls were not flashed to make them weatherproof which violates clause 1402.2 of the applicable 1997 Uniform Building Code. This condition was observed throughout the complex.

- Reverse lapped building paper and missing building paper was discovered which violates clause 1402.1 of the UBC. This condition was observed at the bellybands.

(CP 1237-39.)

B. Warranty Requests and Secret Dissolution.

The condominium unit owners testified as follows:

- Diana Brooking:

> Though it responded to some [of my warranty claims], the developer did not respond to many of these requests including the caulking, the entire grout problem, torn vinyl flooring in the bathroom, and loose carpet. **Eventually, I gave up trying** to get the developer to respond because I believed that the one year warranty period had expired.

(CP 1204.)

- Samer Koutoubi:

In late January of 2003, I presented a claim to the developer for various warranty issues, including a **swollen wooden window frame caused by water leaks**, a difficult locker door, cracks in our bathtub, varicolored grout in the master bedroom bath, poor heating in the upper floors, inadequate venting for the dryer, and separation in the hardwood floorboards of the entryway. Attached is a true and correct copy of our correspondence to the developer on these issues.

The developer never responded to our requests for warranty work.

I was not told that the developer was planning to dissolve, or had dissolved. Had I known that the developer was going to dissolve, I would have asked the Board to take immediate steps to protect our warranty rights.

(CP 1210.)

- Kirsten Campbell:

In May of 2003 I lodged a warranty claim with Theresa May who worked on behalf of the developer for warranty claims. I advised her that **the plaster and paint underneath my outside deck was coming apart and falling because, I believed, of water intrusion.**

I missed work to meet one of the developer's employees at my home to show him the problem, but he did not arrive and I did not even receive a phone call to say he would not show up.

I tried to arrange another appointment with the developer, but received no further response.

(CP 1215.)

- Allan Crouch:

I had a warranty claim which I made to the developer for nail pops in the walls; the developer never fully addressed that claim.

I was not told that the developer was planning to dissolve, or had dissolved. Had I known that the developer was going to dissolve, I would have taken steps to ensure that the Association's legal rights were fully protected before dissolution happened.

To the best of my knowledge, prior to dissolving at end of December, 2004, Colonial Development, LLC (the developer which sold me my unit) made no inquiries of the Board or the Association as to whether there were outstanding warranty issues, and made no investigation into whether there were defective construction issues at the project.

(CP 1221.)

In addition, the Association and its members made the following warranty requests:

- Molly Burdina (on behalf of the Association, September 30, 2002)

Lastly, regarding the issue of water leaking into Ms. Musselwhite's window, the HOA is very concerned about water damage that has been done to the side of building A. Two HOA board members saw a medium size hole in the siding and promptly called James Palmer because of their concern. Mr. Palmer came out to the property and stated that he would patch up the hole, but this has been an unacceptable solution. Because Colonial Development has been unsuccessful in stopping the leaking into A-102, we feel that water may be leaking in from another source or has become trapped between the siding and the paper. We ask that Colonial Development work directly with the Emily Lane Board of Directors regarding the issue of potential external water damage.

(CP 1228.)

- Aleshia Johnson aka Aleshia Cooke

    - July 8, 2002:

I am trying to get a hold of Jim Palmer. I have left him a message on his voicemail to contact me ASAP re another leak in our home. Jim was out to our unit (A-201) a few months back and I had pointed out a leak coming from a window from the spare bedroom. He indicated he would be out the following week. Again, haven't heard back from him and since the bad weather these last 2 days the leak has gotten worse and needs immediate attention.

(CP 1230.)

    - December 16, 2002:

We are experiencing water leakage from the same window that was previously repaired a few months ago. It apparently was not fixed correctly and we would like someone to come out as soon as possible to fix this due to the bad weather we have been having.

(CP 1231.)

    - February 21, 2003:

LOG RE: FOLLOW-UP CONTACTS:

*2/21/03: called to follow-up to siding issue. TM [Theresa May] said there is water damages from the roof allowing water to go thru siding. She was going to be receiving a report today re: the issue.

(CP 1234.)

    - May 2, 2003:

I am following up with your office re: a message I left earlier this week. We had talked a few weeks ago about our window that will need repair due to water damage and

> you informed me you would have the professionals call me to schedule an appointment. To date, I have not been contacted. Could you please have them call me during the day at (206) 652-8658 to schedule this appointment? We have been very patient and would like to resolve these issues in the near future.

(CP 1233.)

C. The Defects Were Open and Apparent to The LLC and its Members During Construction.

The LLC members were experienced construction professionals, frequently on site to review construction quality, and the building envelope was opened on at least some occasions to correct leaks. (CP 1643-44, 1648-49). The members were kept apprised of later warranty requests by owners. (CP 918, 921, 924, 927, 930, 2139, 2151-52)

Engineer Lang testified that virtually all the defects should have been apparent to a builder who monitored the construction. (CP 1239). This, of course, is exactly what the LLC members did. Lang also testified that when siding was later removed, the improper installation of windows should have been apparent. (CP 1239). Accordingly, the LLC's superintendent must have seen the problems, too, at least after the fact.

II. ARGUMENT

A. The LLC's Members Are Liable for LLC Debts.

The LLC's members argue that when winding up an LLC, they need only provide for known, past claims, but can ignore ongoing

obligations such as the implied warranty of quality. That is not what the statute says. RCW 25.15.300 reads as follows:

> A limited liability company which has dissolved shall pay or make reasonable provision to pay all claims and obligations, including all contingent, conditional, or unmatured claims and obligations, known to the limited liability company and all claims and obligations which are known to the limited liability company but for which the identity of the claimant is unknown.

Obviously a contingent, conditional, or unmatured "obligation" is something different than a past claim. The LLC and its members have never claimed to be ignorant of their four-year warranty obligation under RCW 64.34.445 and 64.34.452.

The LLC members had a duty under RCW 25.15.300 to "make reasonable provision" to satisfy this obligation. It is an onerous obligation, because in essence, under RCW 64.34.445 a developer is strictly liable for all building-code violations so long as the cost of repair is not clearly disproportionate to the value to the Association. *Park Ave. Condo. v. Buchan Devs.*, 117 Wn. App. 369, 384, 71 P.3d 692 (2003). Yet here the LLC made **no provision** to deal with that obligation whatsoever!

Because the members failed to wind up the LLC properly, they are not entitled to immunity from liability for LLC debt. RCW 25.15.300(2).

B. The LLC Members Are Liable as Trustees of Corporate Assets, Including Insurance Assets and Choses in Action.

The LLC's undistributed assets include insurance policies, claims against subcontractors, and additional-insured rights under its subcontractors' insurance policies. These assets are worthless to the LLC's members, but they have not vanished. *Walden Home Builders v. Schmit*, 326 Ill. App. 386, 62 N.E.2d 11, 13 (1945). ("[W]hen a corporation is dissolved, its assets do not vanish . . . .")

Once the Association establishes with reasonably certainty that the LLC is liable for the cost of repairing damage at the buildings, then some or all of the LLC's insurers could well have coverage duties with respect to the claims. *See, e.g., Dewitt Constr. v. Charter Oak Fire Ins. Co.*, 307 F.3d 1127, 1133 (9th Cir. 2002), WAC 284-30-330(6).

Counsel for the LLC and members argues fervently that the LLC's insurance is not an undistributed asset because it provides no coverage. Setting aside the troubling question of why the LLC and its members would ever advance this argument, which is directly contrary to their own interests the coverage question is not before this court. The insurance is an asset of potential value at least, and the Association should be permitted to recover against it.[1] Likewise the LLC's claims against the

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[1] The LLC's citations to *Gilliam v. Hi-Temp Products, Inc.*, 260 Mich.App. 98, 677 N.W.2d 856 (2004) and *Blankenship v. Demmler Mfg. Co.*, 89 Ill.App.3d 569, 411 N.E.2d 1153 (1980) are unpersuasive. In *Gilliam*, the court dealt with an attempt to reach insurance assets consisting of an "expired" third-party liability policy, when the claim was asserted long after the deadline under Michigan's detailed process for asserting

subcontractors who built Emily Lane are a valuable asset of the LLC; the members hold them in trust for the LLC members and should be prohibited from squandering them.

C. The LLC Members Fraudulently Received LLC Assets

Under RCW 19.40.051(a), a transfer is constructively fraudulent if (1) the creditor's claim arose before the transfer, (2) the transfer was "not for value" and (3) the transfer rendered the company insolvent. Under RCW 19.40.031(a)(2), a transfer is fraudulent if (1) the claim arose before the transfer, (2) the transfer was not for reasonably equivalent value, and either (3) the LLC's remaining assets were unreasonably small in relation to its business, or (3) the LLC intended to incur or should have believed it would incur debts beyond its ability to pay. Here the cause of action against the LLC arose and accrued on the sale of the first condominium unit. RCW 64.34.452. And, the transfers left the LLC with no cash assets.

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claims against a dissolved corporation had expired. The court acknowledged that its ruling went generally against the tide of authority, but explained that the cases reaching an opposite conclusion did not construe Michigan's detailed Business Corporations Act. 677 N.W.2d at 870.

In *Blankenship* the plaintiff sought leave to reassert a claim against a dissolved corporation in the event that undistributed insurance assets were found during discovery, but apparently plaintiff made no mention of asserting a possible claim against the dissolved corporation's *shareholders* as trustees of corporate assets. 411 N.E.2d at 1157. The court correctly observed that even if there were insurance assets, an action against the dissolved corporation would be impossible. Plaintiff identified the wrong potential defendant, and accordingly, the trust fund doctrine as pertains to insurance in the hands of *corporate successors* was not even raised.

But the LLC members contend, without authority, that they had a "right" to the return of their invested capital, making that return an exchange "for value." But any such "right" is subject to limits, including RCW 25.15.300(2) which provides that the LLC first "shall pay or make reasonable provision to pay all . . . obligations, including all contingent, conditional, or unmatured claims and obligations. . ."

The members cite to the fascinating opinion of Judge Posner in *Scholes v. Lehmann*, 56 F.3d 750 (1995), claiming it supports their proposition that "the Seventh Circuit has established a rule that a distribution from a partnership to a limited partner, to the extent of the limited partner's investment, is a transfer for reasonably equivalent value." (App. Response/Reply at 37). The members have misunderstood *Scholes*. In *Scholes*, a receiver sought recovery of improperly transferred profits, but never asked for disgorgement of returned capital investment, from several participants in a Ponzi scheme, including a number of innocent churches. No "rule" that a return of capital investment is automatically an "exchange" of "reasonable equivalent value" was even hinted at.

Important here is the common sense notion that investors in an enterprise should be the first to bear the financial risk of its failure, not third-party creditors and customers who deal with it at arm's length. Accordingly, the courts have held that it is not proper for members of an

LLC to prefer themselves to LLC creditors. If investors get their money out *before* creditors, the court is allowing entrepreneurs to place the financial risk of their enterprise on creditors, rather than on the investors who knew the risks, controlled the operations, and accepted the gamble. Accordingly, *a return of invested capital is not "for value" as a matter of law. Hullett v. Cousin*, 204 Ariz.292, 298-99, 63 P.3d 1029 (2003).

D. The Members Have Liability As Declarants

The LLC is a consortium of professional builders who acted in concert solely to construct, market, and sell the Emily Lane project. After canceling the LLC, the members acted as declarant by pretending the LLC was a going concern and offering to investigate the defects and propose repairs to the owners. In short, the members exercised the special rights of a "declarant," and are now held to the obligations of a declarant.

The LLC members respond that the "acting in concert" definition of "declarant" was later changed by the Legislature. But that does not replace the pre-existing definition which was relied on by the parties, and which had already been construed by the Supreme Court in *One Pacific Towers HOA v. HAL Real Estate Invs.*, 148 Wn.2d 319, 326, 61 P.3d 1094 (2002). The Legislature cannot retroactively reverse the Supreme Court's decision in violation of separation of powers issues. *1000 Va. Ltd. P'ship v. Vertecs Corp.*, 2006 Wash. LEXIS 873, slip op. at 26 (2006).

Accordingly, the definition of "declarant" in force at the time of the sales is the one this court should use. Under that definition, the members are liable under the Condominium Act as declarants.

E. The Members Assumed Fiduciary Duties To the Association In Managing Its Affairs.

The LLC was in control of the Association for a year. During that time, its Board did exactly *nothing* to safeguard the interests of the Association, despite numerous warranty issues and complaints. The Board never met. It never deliberated. It made no decisions of any sort.

The LLC members installed their agents as Directors. One, Theresa May (who also handled warranty claims) was the personal assistant of member Fred Mus. Another was the president of LLC member Contempra Homes.[2] Ms. May took her direction from Fred Mus, and at times from the other members. She was the agent of the various members, and employee of Fred Mus; they are responsible for her conduct.

F. Issues Remain for Trial on Fraudulent Concealment and Negligent Misrepresentation By LLC Members.

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[2] The Association has dismissed claims against Contempra Homes and Dan Mus *without prejudice*, for reasons having nothing to do with the merits of those claims. Appellant's insinuation that the dismissal of those two defendants has anything to do with the merits of claims against the members is uninformed speculation at best, and erroneous. The Association will re-assert claims against both Contempra Homes and Dan Mus in the event that the LLC is found to be not capable of being sued.

The LLC members argue that the "economic loss rule" shields them against claims for having fraudulently concealed or negligently misrepresented the condition of the buildings. The economic loss rule defines the boundary between tort claims and contract claims, and applies "where a contract allocates the responsibility." *Griffith v. Centex Real Estate Corp.*, 93 Wn.App. 202, 969 P.2d 486 (1998). Here, the rule has no application because *there is no contract between the LLC members and the unit owners to supply an alternate remedy to tort law.*

The LLC members say they had no actual knowledge of construction defects, and even if they "should have known" about them, that is not enough. But the members were experienced construction professionals, on site regularly, personally reviewed the quality of work by subcontractors (including such things as window installations), and they met regularly with their construction supervisor. The nature of the defects is such that as construction professionals doing these things, *the members would have seen the problems during the course of construction.* A reasonable trier of fact could thus conclude that in spite of their denials, the members *did in fact know of at least some of the defects.* That position is bolstered in that the members did nothing to determine whether the defects cropping up in owner warranty complaints were more widespread,

and in that they surreptitiously dissolved the LLC before the warranty period had expired.

The LLC members argue that owner warranty requests in the past did not involve the same defects at issue now, and therefore do not show that members had knowledge of defects. But some of the warranty requests identified the exact same defects at issue here, e.g. improperly installed windows (CP 1210, 1228, 1231, 1237-1239) and deteriorating deck/entry soffits (CP 1215 and 1237-39). This disputed issue of fact must be resolved in favor of the Association.

The members through sales agents told the purchasers that they had no tolerance for construction defects, yet the evidence shows they were likely aware of defects. By the time the warranty requests detailed above came in, the members knew the buildings had problems, yet they took no steps to look further. The trier of fact could well conclude that this shows a failure to use reasonable care to cause the LLC to **obtain and communicate information** about the quality of the buildings, actionable under Restatement (Second) of Torts §552. If the trier of fact concludes that the members actually *knew* of dangerous latent defects, it could find them liable for fraudulent concealment as well.

G. Issues of Fact Remain Regarding Consumer Protection Act Liability of the LLC Members.

The LLC members contend that because some of their deceptive conduct occurred "years after the units were sold" they cannot be liable under the Consumer Protection Act. That argument is a *non sequitur*.

One of the grounds for the Association's Consumer Protection Act claim is that the members failed to disclose their plan to cancel the LLC, despite known warranty claims. This was an act or practice in trade or commerce, part of the LLC's *continuing warranty responsibility*. It was unfair and deceptive to conceal this plan from the unit owners.

The evidence also shows by reasonable inference that members knew of defects by virtue of personally monitoring construction and dealing with warranty claims, yet they did not disclose the known defects to subsequent buyers. The members' only response here is to assert that the defects were "unknown to the Builder," again attempting to substitute defense counsel's interpretation of the facts for the jury's decision.

H. Whether the LLC Members are Entitled to an Award of Fees Is Not Properly Before The Court.

The LLC members requested an award of fees below under the purchase and sale agreements (even though they were not parties to them), and under the Consumer Protection Act. The trial court deliberately held a decision on that request in abeyance, pending the outcome here. There has

been no trial court decision on the issue, and there is no appealable order on it. The court should decline to consider this issue.

I. The LLC's Arguments Regarding the Implied Warranty of Habitability, Breach of Express Contract, and Breach of Express Warranty Are Not Properly Before the Court.

The only basis on which the LLC ever sought or was granted review was on the trial court's refusal to dismiss claims against it by virtue of its dissolution; the LLC argued that interlocutory appeal was appropriate because that question involves a "controlling question of law." (CP 1159-60, 1104-1105.) The LLC never sought review of the trial court's refusal, on the merits, to dismiss the claims against it for breach of implied warranty of habitability, breach of fiduciary duty, violation of RCW 19.40, breach of the Condominium Act's warranties of quality, Consumer Protection Act violations, fraudulent concealment, and negligent and fraudulent misrepresentation.

Now, the LLC seeks to "bootstrap" this host of issues it lost at summary judgment into this appeal, even though it neither sought nor was granted review of those issues. That request should be denied.

Some of these issues and arguments were never even put before the trial court. For example, the LLC's Brief on appeal urges that the Association "failed to identify any specific clause in the Purchase and Sale Agreement which Colonial Development, LLC allegedly breached or any

factual basis on which its breach of contract claim is based." (Brief of App. at 31). But there is not a breath of an argument about a lack of evidence to support claims for breach of contract and express warranty in the arguments advanced below. (CP 146-180, 650-681). The LLC argued only that warranties had been *disclaimed*, a notion that was properly rejected by the trial court.[3] If the court concludes these issues have been properly appealed, the Association stands on its arguments below, and in its prior brief.

The LLC is correct, however, that it did argue below that the owners' implied warranty of habitability claims were waived, and/or were not supported by evidence. (CP 167, CP 671-72). The Association's brief obliquely suggests otherwise (see Brief of Resp. at 34), and is wrong on

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[3] The LLC's counsel accuses the Association of "blatantly misleading the court" as to what was argued below. That is certainly not the Association's intention, though candidly its counsel has been known to make a mistake from time to time, especially when it comes to "blunderbuss" motions practice such as we have in this case. What the LLC did argue below was that the "limited" express warranty in the purchase and sale agreements was the entirety of the Association's express warranty rights (a position the LLC has now apparently abandoned) - but that is not the same as arguing that the Association failed to identify the basis for an express warranty claim.

There appears to be a basic misunderstanding on the part of the LLC about the nature of the Association's express warranty claims. The LLC wants to argue about whether there is evidence that it breached its so-called "limited warranty" (Brief of Appellant at 31-32). From the Association's perspective, that limited warranty is nothing but a meaningless laundry-list style disclaimer that is void under *Park Ave. Condo. v. Buchan Devs.*, 117 Wn. App. 369, 375, 71 P.3d 692 (2003), in fact, it's the very same form! (CP 2093-2120).

The Association has always been concerned instead about the LLC's breach of its warranty to build to plans, which appears at paragraph 29 of the NWMLS form purchase and sale agreements used by the LLC in selling the units. See Brief of Respondent at Footnote 20. Whether Form 29 applies or not was argued below, but no credible assertion can made that the Association "failed to present any evidence" on the subject, or failed to identify the contract terms that concerned it.

that point. The Association should have said that the issue of whether there is sufficient evidence to support the implied warranty of habitability claim is not properly before this court because interlocutory review of that issue was not sought or granted. On appeal, the LLC has not argued waiver. If waiver or the sufficiency of evidence are before the court, the arguments still have no merit as noted in footnote 21 of the Association's Brief. The LLC offers no response.

J. SB 6531 Applies Retroactively and Preserves the Association's Claims Against the LLC

The parties agree that SB 6531 applies retroactively if: (1) the legislature intended retroactive application, (2) the statute is "remedial," or (3) the statute is "curative."

1. The Legislature Intended SB 6531 to Apply Retroactively.

Despite SB 6531's silence regarding retroactive application, its legislative history strongly suggests retroactive intent:

> Chairwoman Pat Lance: "But I imagine it does have some interesting consequences for those who might have relied on there not being this three year window, which is the reason why you're here with the bill... So um..."
>
> Senator Brian Weinstein: "Well, **it doesn't make sense to me that an LLC could dissolve and just have its claims go into Never-Never Land, and** ***so if people were relying on it, they shouldn't have been relying upon it because it's almost fraudulent*** **in my opinion.** And that's what the Bar saw fit to do, at least with the Corporations statute.

(Appendix E to Brief of Respondent) (Emphasis added). The LLC is understandably vexed by this legislative history. So, the LLC simply pretends that it does not exist, and asks the Court to follow suit.[4]

2. SB 6531 Is Remedial Because It Relates To Practice, Procedure, or Remedies and Does Not Affect Any Vested Rights.

"A statute is remedial when it relates to practice, procedure, or remedies and does not affect a substantive or vested right." *Ballard Square Condominium Owners Association v. Dynasty Constr. Co.*, 158 Wn.2d 603, 617, 146 P.3d 914 (2006).

a. SB 6531 Is Procedural Rather Than Substantive

> Statutes concerning the survival period of a corporation after dissolution are generally construed as procedural rather than substantive. . . . As a remedial or procedural matter, the survival period adopted after dissolution may apply to corporations dissolved before the effective date of the new survival statute.

Quintana v. Los Alamos Medical Center, Inc., 119 N.M. 312, 314, 889 P.2d 1234 (1994). Like the corporate survival statute in Quintana, SB 6531 operates to alter the procedure by which a corporate entity (here, an LLC) may avoid liability by dissolution. Appellant LLC argues that prior

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[4] Appendix E to the Brief of Respondent contains a verbatim transcript of selected portions of that House Judiciary Committee hearing. Because Colonial objects to Appendix E, concurrent with this reply brief, the Association is filing a Statement of Additional Authorities which attaches the audio file for the Judiciary Committee hearing regarding SB 6531. The Court may also take judicial notice of the audio file publicly available at http://www.tvw.org/search/siteSearch.cfm?keywords=House%20Judiciary

to SB 6531 the procedure for avoiding liability was simple: the LLC had only to procure a certificate of cancellation. While the Association disagrees with Appellant's interpretation of RCW 25.15.070(2)(c),[5] the LLC is still–even under its own argument–describing a procedure by which an LLC may avoid liability.

b. Because LLC Cancellation Procedures Have Always Been Statutory, Appellant Had No Vested Right to Rely On the Former Procedures

Appellant LLC concedes that both before and after SB 6531, the procedures for avoiding LLC liabilities via cancellation were set forth solely in RCW chapter 25.[6] There is no "vested right" to such a statutory defense.

> A cause of action [or defense] that exists only by virtue of a statute is not a vested right and it can be retroactively abolished by the legislature. . . . [T]he legislature may do so even if [a] lawsuit is pending. *E.g., Sparkman*, 78 Wn.2d 584 at 586 (defendant's right to a **usury defense** provided by statute was not a vested right and the legislature could extinguish the right to the defense by an enactment passed after trial had occurred and prior to a decision on appeal) . .

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[5] The fact that an LLC's existence "as a separate legal entity" ends upon cancellation of the LLC probably means that the LLC's existence continued, albeit in the form of its merged identity with its members, rather than as a separate legal entity.

[6] "The legal status of limited liability companies in Washington is governed by the Washington Limited Liability Companies Act, Chapter 25.15 RCW, and not the common law." (Colonial's Reply Brief at 11.)

Ballard Square, at 617-18 (emphasis added). Because Appellant LLC's cancellation defense is based solely on statute, it and its members had no vested right to rely on the former cancellation procedures, and the Legislature was free to retroactively alter them at any time.

c. Remedial Statutes Apply Where The Statute Is Silent Regarding Retroactivity.

In three prior cases, courts have determined that corporate survival statutes like SB 6531 should apply retroactively: *Quintana v. Los Alamos Medical Ctr.*, 119 N.M. 312, 889 P.2d 1234, 1236 (N.M. Ct. App. 1994); *Walden Home Builders v. Schmit,* 326 Ill. App. 386, 62 N.E.2d 11, 13 (1945); and *United States v. Village Corp.,* 298 F.2d 816, 819 (1962). The LLC would distinguish these cases by arguing that "in each of these cases there was some indication that the Legislature intended the statute to be retroactive." (Reply at 17.) That argument is misguided.

In *Quintana* and *Walden Home Builders,* the courts neither quoted the new survival statute nor analyzed whether the legislature intended retroactive application. They simply applied the statutes retroactively because they were remedial on their faces, like SB 6531. In *Village Corporation* the new survival statute applied to all "existing" corporations. The parties debated whether a corporation with a revoked corporate charter was an "existing" corporation. While the Court did decide that the

legislature intended to include such corporations, once again, the retroactivity analysis turned only on the question of whether the statute was remedial. *Village Corporation,* 298 F.2d at 818-19. No finding of express legislative intent was dispositive in any of the three cases.

3. SB 6531 Is Curative Because It Clarifies An Ambiguity In RCW 25.15.070(2), to Wit, Does The End Of an LLC's "Separate" Existence Mean That Claims Against The LLC Abate?

Curative statutes clarifying statutory ambiguities are retroactive. It acknowledges also that SB 6531 explains how an LLC may avoid liability via cancellation. Disagreement comes when the LLC argues that there was no ambiguity in the old law at RCW 25.15.070(2)(c), and that prior to SB 6531 the rules regarding abatement of claims against cancelled LLCs were "perfectly clear."

But RCW 25.15.070(2)(c) provides: "A limited liability company formed under this chapter shall be a separate legal entity, the existence of which **as a separate legal entity** shall continue until cancellation of the limited liability company's certificate of formation." (emphasis added) This appears not in the *dissolution* section of the statute, but in the section on *creating* an LLC. Prior to the enactment of SB 6531, this statute was ambiguous as to what happened to claims by and against a cancelled LLC.

What does the phrase "as a separate legal entity" mean? "[A] court must not construe a statute in a way that renders statutory language meaningless or superfluous." *Ballard Square*, 158 Wn. 2d at 610. Yet the LLC ignores the "separate existence" concept, interpreting the statute as if it read: "an LLC's existence shall continue until cancellation." If the phrase has meaning, it must be that the end of an LLC's "separate" legal existence under RCW chapter 25 is not an end of its existence altogether.[7] Thus, the phrase "as a separate legal entity" is at least ambiguous.

Further, the court must decide whether the end of an LLC's "separate" existence unambiguously bars all future claims against it. Once again, the LLC ignores this question. At common law, despite the fact that partnerships had no separate existence, plaintiff had the right to bring claims against partnerships by suing "the persons individually who compose the firm."[8]

Last, RCW chapter 25 says *nothing* about whether claims against cancelled LLCs survive or abate. In the absence of evidence regarding the legislature's intent, this silence is ambiguous. *State v. Jacobs*, 154 Wn.2d 596, 603-04, 115 P.3d 281 (2005) (Where statute was silent as to whether

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7 For example, at common law, partnerships existed even though they did "not exist in law apart from the individuals composing [them]." *Yarbrough v. Pugh*, 63 Wash. 140, 145, 114 P. 918 (1911).

8 *Id.*

sentence enhancements applied consecutively or concurrently and "the legislative intent gleaned elsewhere in the statute [did] not conclusively resolve the issue," the statute was ambiguous). Similarly, RCW 25.15.070(2)(c)'s silence on the question of whether claims against a cancelled LLC abate or not is an ambiguity.

4. The LLC Has Waived Its Rights to Assert a Cancellation Defense By Litigating the Case for Nearly A Year Before Advancing the We-Do-Not-Exist Defense.

The Association does not contend that the LLC waived its defense merely by defending, an argument that was rejected by some members of the *Ballard Square* court. 158 Wn.2d at 625 (Johnson, J., concurring.) The issue rather is whether the *manner* in which the LLC defended itself was inconsistent with its subsequent defense that it did not exist - a question which was not apparently at issue in *Ballard Square.*

The LLC says nothing to contradict the lessons of *King v. Snohomish County*, 146 Wn.2d 420, 47 P.3d 563 (2002) and *Lybbert v. Grant County*, 141 Wn.2d 29, 39, 1 P.3d 1124 (2000), whereby a defendant who engages in scorched-earth litigation without disposing of threshold defenses in a cost-effective manner runs the risk of being deemed to have waived the defense.

Indeed, from a waiver standpoint, the LLC's conduct here was far worse than any described in prior Washington case law: here, the LLC

knew about the cancellation defense but intentionally delayed making the argument and even misled the Association about the facts of the defense in response to the Association's claim notice. Moreover, Washington's Supreme Court in *King* has already conclusively rejected any suggestion that merely asserting a defense in a "laundry list" of defenses (there were 35 affirmative defenses in this case) is a safe harbor from waiver.

The defense offers no reasonable justification for having delayed the resolution of the issue of the LLC's existence for nearly a year, while expending many hundreds of attorney hours on disputes unrelated to that threshold defense. The LLC's conduct was a waiver as a matter of law.

RESPECTFULLY SUBMITTED this 12th day of January, 2007.

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By_____

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No. 58825-7-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION 1

COLONIAL DEVELOPMENT, LLC, a Washington limited liability company,

Defendant// Appellant,

v.

EMILY LANE TOWNHOMES CONDOMINIUM OWNERS' ASSOCIATION, a Washington nonprofit corporation,

Plaintiff// Respondent/Cross-Appellant.

CERTIFICATE OF SERVICE

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I hereby certify that on the 12th day of January 2007, I did cause to be served true and correct copies, via the indicated method of delivery, of:

REPLY BRIEF OF RESPONDENT/CROSS-APPELLANT EMILY LANE TOWNHOMES CONDOMINIUM OWNERS' ASSOCIATION

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I certify under penalty of perjury under the laws of the State of Washington and the United States that the foregoing is true and correct.

Dated January 12, 2007 at Seattle, Washington.

Mariah Lynge